MICROFINANCE POLICY: REWIND OR TURNAROUND?

RBI's role in giving MFIs policy support was remarkable, but an appropriate regulatory framework for the sector is long overdue

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As the debate on the future of microfinance continues, it is worth examining the Reserve Bank of India's (RBI's) own discourse from 1998 onwards. This is particularly relevant after the Economic Survey tabled on February 26 and the Budget speech both make positive references to microfinance as being an important part of the inclusion agenda.

Contrary to what we are led to believe – that microcredit grew on its own and RBI stepped in at this stage to take note of the current practices – RBI played a crucial and catalytic role in the development of microcredit by encouraging and prodding banks to lend to micro-finance institutions (MFIs).

In 1998, MFIs had made early forays and the practitioners had asked for a policy framework. In response, the National Bank for Agriculture and Rural Development (Nabard) set up a task force on Supportive Policy and Regulatory Framework for Microfinance in the late 1998. This task force found microfinance an emerging activity to be nurtured. It was ahead of its times in calling for registration, and regulation through a self-regulatory organisation (SRO). Pending an SRO, the task force recommended that RBI should put an interim regulatory framework. At the same time, Sa-Dhan, the association representing diverse non-governmental and private sector players in microfinance, was established. Sa-Dhan was expected to evolve as the voice of the industry and an SRO.

This task force had a profound and simultaneous impact on policy making. In April 1999, the word microcredit was used for the first time in the credit policy, months after the task force was set up, but ahead of its report (October 1999). The statement said, "Micro-credit Institutions ... are important vehicles for delivery of credit to self-employed persons, particularly women in rural and semi-urban areas."And further: "A special cell ... is being set up in RBI in order to liaise with Nabard and microcredit institutions for augmenting the flow of credit to this sector. The time frame for the cell ... will be one year and its proposals will be given the highest attention."

The credit policy (and a notification in April 1999) drew a distinction between small loans given by banks (with a ceiling on interest rates) and the loans given to MFIs for on-lending (without a ceiling). This notification created a two-way incentive for the commercial banks:

- to abdicate (to the extent possible) their own work of reaching out to the poor;
- to advance bulk loans to MFIs with no ceilings.

The banks did not have a level playing field, but were possibly happy to outsource small credit to MFIs. This opened bank finance to the MFIs, who were largely dependent on donor money.

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The task force submitted its report in time for the mid-term review of the credit policy. RBI showed remarkable alacrity in acknowledging the recommendations. The review said, "The recommendations made by the Task Force are being 'processed' by Nabard in consultation with RBI and Government as appropriate." The recommendations of the task force were already creeping into the policy much before "processing", which was unlike the usual policy-making protocol of putting the report in the public domain, encouraging deliberations and incorporating feedback to convert recommendations into actions.

The mid-term review reiterated the importance of MFIs and asked banks to include microcredit in their corporate strategy to be reviewed on a quarterly basis. A detailed notification of February 2000 made six significant points:

- No interest cap on loans to MFIs and their loans to clients.
- Freedom to banks to formulate their own model/conduit/intermediary for extending microcredit.
- No criteria for selecting MFIs.
- Banks to formulate their own lending norms.
- Banks to formulate a simple system, minimum procedures and documentation for augmenting flow of credit by removing all operational irritants.
- Banks to include microcredit at the branch, block, district and state credit plans with quarterly progress to be reported to RBI.

The fact is that RBI gave policy support without an appropriate regulatory framework. The notification defining microcredit is stark: "The provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standards. Micro Credit institutions are those which provide these facilities."

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We do not know if it was a deliberate attempt to keep this vague by leaving out amounts or incomes. However, the regulatory discourse was just about opening up another channel of financial services.

Even as the somewhat regressive Malegam committee report is being discussed, RBI, on February 14, released a master circular on microcredit which refers to its historical circulars, with little addition: "A joint fact-finding mission looked at the issues plaguing the microcredit sector and ends with saying that findings were brought to the notice of the banks to enable them to take necessary corrective action where required."

In the current circumstances, the finance minister has made a bold and affirmative statement in the recent Budget. He has also thrown in some money for an India Microfinance Equity Fund. This augurs well for the MFI sector — showing policy continuity rather than policy turnaround based on Malegam's recommendations. Otherwise we would only be able to say microcredit had a bright future behind it, not ahead of it.

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